

Private Letter Ruling: Dividends received from the two corporations described in the request may be subtracted under IITA Section 203(b)(2)(L) because the corporations have been designated as High Impact Businesses and conduct activities in enterprise zones.

September 17, 2002

Dear:

This is in response to your letter dated August 15, 2002, in which you request a Private Letter Ruling on behalf of COMPANY1. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 86 Ill. Adm. Code Section 1200.110 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to COMPANY1 for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY1 nor a related taxpayer is currently under audit nor involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

1. This request for a Private Letter Ruling ("PLR") is prepared by the undersigned who is acting as an agent for our client, COMPANY1, pursuant to an original Form 2848, Power of Attorney, submitted herein.
2. This PLR is not requested with regard to hypothetical or alternative proposed transactions. The PLR is requested to determine the income tax consequences of the actual business practices of COMPANY1.
3. COMPANY1 is not currently under audit by the Department or engaged in litigation with the Department in regard to this tax matter.
4. The Department has not previously ruled regarding this matter for COMPANY1. Neither COMPANY1 nor COMPANY2 has submitted the same or similar issues to the Department.
5. COMPANY1 requests that certain information be deleted from the PLR prior to dissemination to others. COMPANY requests that its name, address, location of its headquarters, descriptions of products being sold and the name of its representative be deleted.
6. COMPANY1 knows of no contrary authority to the authorities referred to and cited below.

### **Statement of Material Facts**

COMPANY1 is the parent company of a group of insurance companies, and files as the designated agent of the unitary group of insurance companies on COMPANY1's Illinois income tax return. The COMPANY1 insurance group apportions its income according to 35 ILCS 5/304(d).

COMPANY1 and two subsidiary corporations, COMPANY3 and COMPANY4 (collectively referred to as "COMPANY1"), own stock of two Illinois corporations, COMPANY5 and COMPANY6. The COMPANY1 entities began purchasing COMPANY5 and COMPANY6 stock in the following years:

	<u>COMPANY5</u>	<u>COMPANY6</u>
COMPANY1	1984	1990
COMPANY3	1998	1995
COMPANY4	1988	1991

COMPANY5 is located in a U.S. federal Foreign Trade Sub-Zone (Sub-Zone F22), which was approved as a Foreign Trade Sub-Zone as of December 11, 1992. COMPANY5 received an Illinois High Impact Business ("HIB") Certification for Designation from the Illinois Department of Commerce and Community Affairs dated June 15, 2001.

COMPANY6 is also located in a U.S. federal Foreign Trade Sub-Zone (Sub-Zone 114A), which was approved as a Foreign Trade Sub-Zone as of December 21, 1984. COMPANY6 received an Illinois HIB Certification for Designation from the Illinois Department of Commerce and Community Affairs dated July 31, 1987.

The HIB designations are effective for a period not to exceed twenty years. Both COMPANY5 and COMPANY6 pay quarterly dividends to their shareholders.

COMPANY5 and COMPANY6 have both property and payroll located in a Foreign Trade Sub-Zone in Illinois. COMPANY5 and COMPANY6 may also have other locations in Illinois which are located in an Illinois enterprise zone, however, neither company conducts "substantially all" of their business operations in an Illinois enterprise zone.

### **Ruling Requested**

1. COMPANY1 respectfully requests a binding PLR from the Department confirming that all dividends received from COMPANY5 and COMPANY6 would qualify for the subtraction modification codified in IITA §293(b)(2)(L) as dividends paid by a corporation that conducts business operations in a federally designated Foreign Trade Sub-Zone and that is designated a High Impact Business located in Illinois.
2. COMPANY1 is eligible for the subtraction modification for all dividends paid by COMPANY5 after June 15, 2001, and for all dividends paid by COMPANY6 after July 31, 1987.

### **Relevant Authorities**

The Illinois Income Tax Act ("IITA") defines base income of a corporation as the taxpayer's taxable income for the taxable year as modified. (35 ILCS 5/203(b)(1)). One subtraction modification to arrive at base income is codified in IITA §203(b)(2)(L) and reads as follows:

An amount equal to those dividends included in such total that were paid by a corporation that conducts business operations in a federally designated Foreign Trade Zone or Sub-Zone and that is designated a High Impact Business located in Illinois; provided that dividends eligible for the deduction provided in subparagraph (K) of

paragraph 2 of this subsection shall not be eligible for the deduction provided under this subparagraph (L). (35 ILCS 5/203(b)(2)(L)).

The above statute provides an exception to the HIB dividend subtraction modification for dividends eligible for deduction under subparagraph (K). Subparagraph (K) provides a subtraction modification for dividends that were paid by a corporation conducting substantially all of its business operations in an Illinois Enterprise Zone. (35 ILCS 5/203(b)(2)(K)). Therefore, dividends paid by a corporation that meets both the Enterprise Zone requirements in (K) and the HIB operating in a Foreign Trade Zone requirements in (L) may only be subtracted under the Enterprise Zone statute.

The statute does not contain any language specifying the level of operations to be conducted in the Foreign Trade Zone or Sub-Zone, nor has the Department promulgated a regulation discussing the required level of operations to be conducted within a Foreign Trade Zone or Sub-Zone. The Department has not published any General Information Letters or Administrative Hearings addressing this topic, nor has the issue arisen in any published Illinois court case.

The Department has issued two Private Letter Rulings on this topic regarding the level of operations needed to be conducted in the Foreign Trade Zone or Sub-Zone. In Private Letter Ruling IT-01-00080PLR (Aug. 2, 2001) and IT-0100010-PLR (Oct. 30, 2001), the Department concluded that dividends paid by a HIB corporation qualify for the subtraction modification under 35 ILCS 5/203(b)(2)(L) provided that the corporation conducts any business operations in a federally designated Foreign Trade Zone or Sub-Zone, so long as the dividends are not eligible for the subtraction modification under 35 ILCS 5/203(b)(23)(K).

In the rulings, the Department analyzed its Regulation Section 100.2480 concerning dividends paid by a corporation that conducts substantially all its business operations in an Illinois Enterprise Zone, which regulation relates to 35 ILCS 5/203(b)(2)(K). The Department applied that Regulation with the following modifications. First, the corporation must be designated a HIB located in Illinois. Second, the corporation must conduct business operations in a federally designated Foreign Trade Zone or Sub-Zone, rather than "substantially all" of such operations as required under 35 ILCS 5/203(b)(2)(K), Regulations Section 100.2480(b) shall be applied by substituting the term "greater than 0%" in place of the term "95% or more". Finally, dividends paid must not be eligible for the subtraction modification provided for dividends paid by a corporation that conducts substantially all of its activities in an Enterprise Zone.

According to the Department, a corporation designated a HIB in Illinois and that apportions business income to Illinois under subsection (a) of IITA Section 304 must compare its property and payroll within a federally designated Foreign Trade Zone or Sub-Zone to the corporation's property and payroll everywhere. The result of the property and payroll factor computations is then divided by 2 (by 1 if either factor has a denominator of 0). If the amount so computed is greater than 0%, and the dividends paid are not eligible for the subtraction modification under 35 ILCS 5/203(b)(2)(K), the dividends paid will qualify for the subtraction modification provided by 35 ILCS 5/203(b)(2)(L).

## Conclusion

COMPANY1 has therefore concluded that the dividends it receives from COMPANY5 and COMPANY6 would qualify for the subtraction modification codified in 35 IITA 5/203(b)(2)(L) (sic) since both COMPANY5 and COMPANY6 are designated a HIB, are conducting business operations in a Foreign Trade Sub-Zone and do not qualify for the subtraction modification in 35 IITA 5/203(b)(2)(K) (sic). In addition, the subtraction would apply to dividends received from COMPANY5 after June 15, 2001, and from COMPANY6 after July 31, 1987.

Please be advised that the Department is in the process of codifying its interpretation of the IITA Section 203(b)(2)(K) subtraction modification as explicated in the two PLRs to which you have referred. We refer you to proposed IIT regulation section 100.2490 (copy enclosed), which can currently be found on the Department's web-site, [www.revenue.state.il.us](http://www.revenue.state.il.us) (under "Laws and Legal Interpretations – Proposed Rules"). That draft regulation confirms that the Department interprets the 203(b)(2)(K) subtraction to cover dividends paid by a corporation meeting the following criteria: First, the corporation must be designated a HIB located in Illinois. Second, the dividends paid must not be eligible for the subtraction modification provided for dividends paid by a corporation that conducts substantially all of its activities in an Illinois Enterprise Zone. Finally the corporation must conduct business operations in a federally designated Foreign Trade Zone or Sub-Zone.

For purposes of the third and final requirement, proposed regulation section 100.2490(b)(1) states in part that a corporation required to apportion business income to Illinois under IITA Section 304(a) must use a formula which compares the ratio of its property and payroll factors within the Foreign Trade Zone or Sub-Zone to its property and payroll factors everywhere in the manner described in existing IIT regulation section 100.2480 and the two PLRs to which you have referred.

Applying this standard to the situation you have described, the dividends paid to COMPANY1 by COMPANY5 and COMPANY6 are deductible under IITA 203(b)(2)(L). Both COMPANY5 and COMPANY6 are HIBs located in Illinois; both have property and payroll situated in, and therefore conduct business operations from, a Foreign Trade Zone or Sub-Zone under the test described above; and the dividends paid by them to COMPANY1 may not be deducted under IITA 203(b)(2)(K). These dividends therefore qualify for the IITA 203(b)(2)(L) subtraction for dates paid to COMPANY1 after June 15, 2001 (COMPANY5) and July 31, 1987 (COMPANY6) respectively.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely yours,

Jackson E. Donley,  
Senior Counsel-Income Tax